

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company)	
)	
Petition for consent to and approval of an)	
Agreement with American Water Resources,)	Docket No. 02-0517
Inc. "an Affiliated Interest" under Section)	
7-101 of the Illinois Public Utilities Act,)	
as amended.)	

DIRECT TESTIMONY OF

DAVID KOLATA

ON BEHALF OF THE
CITIZENS UTILITY BOARD

CUB EXHIBIT 1.0

March 11, 2003

1 ***I. Introduction***

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is David Kolata and my business address is 208 S. LaSalle Street, Suite 1760,
4 Chicago, Illinois 60604.

5
6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am a Senior Policy Analyst at the Citizens Utility Board (“CUB”).
8

9 **Q. PLEASE OUTLINE YOUR DUTIES AND RESPONSIBILITIES IN THAT**
10 **POSITION.**

11 A. I am responsible for developing consumer policies and legislation relating to the electric,
12 natural gas, water, and telecommunications industries. I also represent CUB before the
13 Illinois General Assembly and serve on the boards of the Universal Telephone Assistance
14 Corporation, the Illinois Telephone Consumer Education Fund, and the Consumer
15 Education Working Group.
16

17 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

18 A. I have a PhD in Political Science from Vanderbilt University, a Masters of Arts degree in
19 Political Science from the University of Toronto, and a Bachelor of Arts degree in
20 Government from the University of Notre Dame.
21

22 **Q. HAVE YOU TESTIFIED IN ANY OTHER CASES BEFORE THE ILLINOIS**
23 **COMMERCE COMMISSION (“COMMISSION”)?**

1 A. Yes, I submitted testimony in Docket Nos. 01-0485 and 02-0441.

2
3 **Q. DO YOU HAVE ANY OTHER EXPERIENCE THAT IS RELEVANT TO THIS**
4 **CASE?**

5 A. Yes. As CUB's representative before the Illinois General Assembly, I was involved in
6 the discussions and negotiations that led to HB 4667 – a bill passed in August 2002 that,
7 among other things, sets limits on joint marketing between gas utilities and their HVAC
8 affiliates. From this experience, I gained a thorough understanding of the goals and
9 intentions behind Sections 7-208 and 7-209 of the Public Utilities Act (also known as
10 P.A. 92-852).

11
12 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

13 A. I am testifying on behalf of the Citizens Utility Board regarding the issues raised by
14 Illinois-American Water Company's ("IAWC" or "Illinois-American") petition for
15 approval of an affiliated interest agreement with American Water Resources ("AWR")
16 pursuant to Section 7-101 of the Public Utilities Act ("PUA"). My testimony addresses
17 the questions raised by the Commission in its December 30, 2002 Notice of Commission
18 Action and Notice of Hearing, specifically question 3 which stated:

19
20 How does this proposal compare and contrast with ICC
21 approved programs in other industries (e.g. the linebacker
22 program in telecom and in consideration of the joint marketing
23 provisions of the affiliate rules for electric and gas companies)?
24

Q. WHAT IS YOUR OVERALL RECOMMENDATION?

A. The Commission should not approve Illinois-American's petition unless the company changes the design of AWR's water line protection program. More specifically, IAWC and AWR should: (1) significantly alter the proposed letter of introduction and other marketing materials and approaches to make them consistent with P.A. 92-852; (2) make additional changes in the proposed letter of introduction to help reduce potential sources of customer confusion; (3) eliminate section 6.1.4 of their proposed agreement for support services; and (4) guarantee that IAWC will provide similar services to non-affiliated companies at reasonable rates if requested.

II. *Illinois-American Marketing Materials Should Be Consistent with P.A. 92-852*

Q. PLEASE DESCRIBE P.A. 92-852.

A. P.A. 92-852 sets limits on joint marketing between gas utilities and their HVAC affiliates. The statute requires that when an HVAC affiliate of a gas utility "markets heating, ventilating, or air conditioning services to the public, it shall include a disclaimer that, if audible, is conspicuous and if printed is of sufficient size to be clearly legible, and that states: (Insert name of affiliate) is an affiliate of (insert name of gas utility) and is not regulated by the Illinois Commerce Commission. Customers are not required to buy products or services from (insert name of affiliate) in order to receive the same quality of service from the gas utility." These requirements apply to all forms of advertising and joint marketing, including printed materials and bill inserts. It also states "while a gas utility employee is responding to a service call related to services provided under tariffs

1 on file with the Illinois Commerce Commission, the employee of the gas utility is
2 prohibited from marketing the services of an HVAC affiliate.”
3

4 **Q. PLEASE DESCRIBE THE GENESIS OF P.A. 92-852 AND DISCUSS HOW IT**
5 **RELATES TO THE JOINT MARKETING RULES ESTABLISHED BY THE ICC**
6 **FOR NATURAL GAS AND ELECTRIC AFFILIATES.**

7 A. The issue of joint marketing between utilities and their affiliates was last addressed by the
8 Commission in Docket No. 00-0586, which specifically pertained to natural gas utilities.
9 Perhaps the most controversial issue in this case was whether the proposed rules on joint
10 marketing between gas utilities and their affiliates should apply to all affiliates or only
11 those affiliates directly in competition with alternative retail gas suppliers (“ARGS”).

12 On one side, utility interveners argued that the natural gas affiliate rules should be
13 consistent with those established by the Commission for the electric industry, and thus
14 should only apply to gas utilities directly in competition with ARGS. On the other side,
15 consumer advocates and HVAC interveners asserted that the gas affiliate rules should
16 apply to all affiliates, and cited specific differences between the electric and natural gas
17 industries to justify this expansion, with aggressive joint marketing between gas utilities
18 and their HVAC affiliates being the main difference cited. In the end, the Commission
19 agreed with the utilities and limited the applicability of the affiliate rules to those
20 affiliates directly in competition with ARGS.

21 Now, if this were the end of the story one might conclude that the Commission
22 should impose few restrictions on joint marketing between Illinois-American and AWR.
23 While the water industry, unlike the electric and natural gas industries, has not been

1 restructured – and so there are no alternative retail water suppliers (“ARWS”) - the
2 proposed water line protection program arguably involves a market over which the
3 Commission has little jurisdictional interest. In other words, if we assumed,
4 counterfactually, that the water industry was restructured, the water line protection
5 program under consideration would not necessarily compete with ARWS.

6 Importantly, however, the Commission’s decision in 00-0586 was not the end of
7 the story, for the issue was soon addressed by the Illinois General Assembly—first
8 through the Joint Committee on Administrative Rules (“JCAR”) and then through the
9 legislative process itself. Having been involved in this process, I can report that
10 legislators expressed two basic concerns about the decision. The first was that joint
11 marketing between gas utilities and their HVAC affiliates led to customer confusion
12 because customers believed they needed to take the service as a condition of utility
13 service. The second concern was that joint marketing gave utility affiliates an unfair
14 advantage over other HVAC companies, as it involved the transfer of monopoly power
15 into a competitive marketplace.

16 Because of these concerns, a process was started that ultimately led to the
17 unanimous approval of P.A. 92-852 by the General Assembly, thus the Public Utilities
18 Act now directly regulates HVAC affiliate marketing.

19
20 **Q. DO YOU THINK THE REGULATIONS ON AFFILIATE MARKETING**
21 **OUTLINED IN P.A. 92-852 SHOULD ALSO APPLY TO THE PROPOSED**
22 **IAWC/AWR WATER LINE PROTECTION PROGRAM?**

1 A. Yes. The issues raised by the proposed water line protection program are exactly the
2 same as those addressed by the General Assembly in P.A. 92-852. For example, the
3 current proposal calls for Illinois-American to send a letter of introduction to its
4 customers on IAWC letterhead (announcing the program) signed by the IAWC president.
5 This creates an atmosphere ripe for confusion, as many customers, particularly senior
6 citizens, may conclude that the water utility itself is offering the program and that they
7 have no choice but to participate. Moreover, the proposed water line protection program
8 also involves the transfer of monopoly assets, which could put other companies offering
9 the service at a competitive disadvantage. Finally, it is worth noting the broad nature of
10 IAWC's proposed affiliate agreement with AWR. As it stands, this agreement, if
11 approved, would allow IAWC to create an HVAC affiliate without additional approval
12 from the Commission, and this would mean that water and gas HVAC affiliates would be
13 treated differently. While water HVAC affiliates could market without restriction, gas
14 affiliates in the same business would face specific limitations on their ability to jointly
15 market, an inconsistency that seems difficult to justify from a policy point of view. For
16 these reasons, the regulations on affiliate marketing codified by P.A. 92-852 should also
17 apply to the proposed IAWC/AWR water line program.

18
19 **Q. HOW SHOULD THE PROPOSED AFFILATE AGREEMENT BETWEEN IAWC**
20 **AND AWR BE CHANGED TO MAKE IT CONSISTENT WITH P.A. 92-852?**

21 A. The proposed letter of introduction, and all other joint marketing materials, should
22 specifically include the disclaimer: "American Water Resources is an affiliate of Illinois-
23 American Water Company and is not regulated by the Illinois Commerce Commission.

1 Customers are not required to buy products or services from American Water Resources
2 in order to receive the same quality of service from Illinois-American Water Company.”

3 This disclaimer should be clearly legible and conspicuous. In addition, Illinois-American
4 employees should be prohibited from marketing the water line protection program while
5 responding to a service call related to services provided under tariffs on file with the
6 Commission.

7
8 ***III. Illinois-American and AWR Should Make Additional Changes in Marketing***
9 ***Materials to Mitigate Customer Confusion***

10
11 **Q. DO YOU RECOMMEND ANY OTHER CHANGES TO THE PROPOSED**
12 **WATER LINE PROTECTION PROGRAM MARKETING MATERIALS?**

13 A. Yes.

14
15 **Q. PLEASE DESCRIBE THESE ADDITIONAL CHANGES.**

16 A. In addition to the changes proposed by Staff witness Mary Everson – which I understand
17 Illinois-American has accepted – I recommend that the marketing materials
18 conspicuously clarify that the water line protection program only covers repair to water
19 lines caused by normal wear and tear, and not acts of nature or human error. I also
20 recommend that all phrases such as “you can’t predict it” be removed from Illinois-
21 American’s proposed letter of introduction and future marketing materials.

22
23 **Q. PLEASE DESCRIBE THE NEED FOR CLARIFYING THAT THE WATER LINE**
24 **PROTECTION PROGRAM ONLY COVERS REPAIRS CAUSED BY NORMAL**
25 **WEAR AND TEAR.**

1 A. The IAWC/AWR water line protection program only covers repairs to water lines
2 damaged by normal wear and tear, a fact obscured by the program's proposed marketing
3 materials. The letter of introduction, for example, mentions the phrase "normal wear and
4 tear" once, but not in a context that specifically states that the policy *only* covers damage
5 caused by normal wear and tear, as all it says is "at any time, normal wear and tear can
6 cause your water line to leak or break." This could be a problematic source of customer
7 confusion. As it stands, the marketing materials encourage the misinterpretation that the
8 water line protection program covers all damage to water pipes, including damage caused
9 by, say, flooding or a construction accident. While the terms and conditions sheet does
10 clarify that only normal wear and tear is covered, the document is written in legalese and
11 customers should not have to search through pages of information to comprehend a basic
12 fact such as what is covered and what is not.

13
14 **Q. DO YOU HAVE ANY SUGGESTIONS ON HOW THE MARKETING**
15 **MATERIALS COULD BE ALTERED TO CLARIFY THE NORMAL WEAR**
16 **AND TEAR ISSUE?**

17 A. Yes. While this could be accomplished in many ways, perhaps the easiest way would
18 simply be to insert a phrase or sentence specifically stating that only problems caused by
19 normal wear and tear are covered by the water line protection program. Using the
20 proposed letter of introduction as an example, one could change the following three
21 sentences to accomplish this end:

22 Q. Change "For just pennies a day, you can be protected
23 from unexpected worries and costs" to "For just pennies a day,
24 you can be protected from unexpected worries and costs caused
25 by normal wear and tear."

1
2 R. Change “American Water Resources, Inc. . . . is pleased to introduce
3 a special water Line Protection Program to cover these unexpected costs”
4 to “American Water Resources, Inc. . . . is pleased to introduce a special
5 water Line Protection Program that covers unexpected costs caused by
6 normal wear and tear to water lines.”
7

8 S. Change “For only \$__ a month, you will be protected from the
9 expense and worry that a broken water service line can cause” to
10 “For only \$__ a month, you will be protected from the expense and
11 worry that a broken water service line produced by normal wear and
12 tear can cause.”
13

14 The last paragraph should also read: “Please read the Program terms and
15 conditions on the back of this letter and keep this information for future reference. You
16 should note that the water line protection program only covers the cost of replacement for
17 water lines damaged by normal wear and tear.”
18

19 **Q. PLEASE DESCRIBE THE NEED FOR ELIMINATING SUCH PHRASES AS**
20 **“YOU CAN’T PREDICT IT” FROM MARKETING MATERIALS.**

21 A. Illinois-American’s proposed letter of introduction states that:

22 “At any time, normal wear and tear can cause your water line
23 to leak or break, as shown on the enclosed diagram. You can’t
24 prevent it. You can’t predict it. And, worst of all, most homeowner
25 insurance policies do not cover repairing it, so you’ll have to pay for it.”
26

27 The phrase “you can’t predict it” should be eliminated from all such marketing
28 materials, as it is patently untrue. I say this for two reasons. First, the company could not
29 possibly offer the water line protection program if the damages it covered were truly
30 random. In order to figure out a price that provides an acceptable profit, Illinois-

1 American/AWR must run a risk analysis to calculate the probability of having to pay for
2 repairs. Thus, the mere fact that the company plans on offering the program shows that it
3 is simply not the case that the need for water line repair is unpredictable. Second, the
4 predictability of the need for water line repair is even further enhanced because the
5 proposed program only covers normal wear and tear. I am not a plumber, but it is hard to
6 believe that those involved in the piping industry do not have a good idea of how long
7 various types of pipe last absent natural disasters or human negligence. In other words, I
8 strongly suspect that the industry knows how long water line pipes are able to function on
9 average with normal wear and tear, and that this estimate forms the backbone of Illinois-
10 American/AWR's risk analysis.

11 The reason this issue is important is that it is the central fact consumers need to
12 consider when deciding whether to participate in the water line protection program. The
13 value of the program depends upon the chances that water lines will break or leak
14 because of normal wear and tear, and the phrase "you can't predict it" gives the
15 impression that it will happen sooner rather than later, when, in fact, many pipes may last
16 over 50 years or more.

17
18 ***IV. Section 6.1.4 of the Proposed Affiliate Agreement Between IAWC and AWR Should***
19 ***Be Eliminated***

20
21 **Q. PLEASE DESCRIBE SECTION 6.1.4 OF THE PROPOSED AGREEMENT FOR**
22 **SUPPORT SERVICES BETWEEN IAWC AND AWR.**

23 A. Section 6.1.4 would essentially allow Illinois-American to offer any services to AWR in
24 the future, provided that such services followed the same terms as the Commission's
25 order in this docket and were acceptable under the Service Contract Act (215 ILCS 152/1

1 et.seq.). This is a very open ended provision. While I am not a lawyer, it is clear that the
2 Service Contract Act would allow IAWC and AWR to participate in a countless number
3 of potential programs, as the definition of service contract in the Act includes “any
4 automobile, system, or consumer product in connection with the operational or structural
5 failure due to a defect in material or workmanship or normal wear and tear.”
6

7 **Q. DO YOU HAVE ANY SUGGESTIONS ON HOW THE COMMISSION SHOULD**
8 **TREAT SECTION 6.1.4?**

9 A. Yes, the Commission should eliminate this provision, as it is inconsistent with its order in
10 Docket No. 00-0586. Further, on its face, this provision forecloses the Commission’s
11 ability to review the appropriateness, prudence and/or legality of future transactions
12 between IAWC and AWR.
13

14 **Q. PLEASE DESCRIBE WHY SECTION 6.1.4 IS INCONSISTENT WITH THE**
15 **ICC’S DECISION IN DOCKET NO. 00-0586.**

16 A. The order in this case proscribed “any transaction between a gas utility and any of its
17 affiliates that is not explicitly addressed in a Commission approved services agreement,”
18 as the Commission reasoned that “service agreements are reviewed for approval with an
19 eye to precluding cross-subsidies.” (p. 8). The issue of cross-subsidization, however,
20 cannot adequately be addressed without looking at the specific details of a proposed
21 program, an action precluded by Section 6.1.4. Under this section, IAWC and AWR
22 could enter into a countless number of other programs, but no matter what the individual
23 circumstances, the compensation for IAWC would be treated the same. Moreover, the

Commission would have no ability to review the programs. While the proposed 15% mark-up might be legitimate in the water line protection program, it might be illegitimate for other possible programs. We cannot know if there is cross-subsidization until we examine the details, and for this reason that Commission should eliminate Section 6.1.4.

V. *Illinois-American Should Provide Similar Services to Non-Affiliates at Reasonable Rates if Requested*

Q. IAWC SUGGESTS IN ITS TESTIMONY THAT IT MIGHT BE WILLING TO OFFER THE SAME SERVICES TO NON-AFFILIATES AS IT WOULD OFFER TO ITS AFFILIATE, GIVEN APPROVAL OF THE PROGRAM BY THE COMMISSION. IS THIS STATEMENT SATISFACTORY?

A. No, the company should *guarantee* that it will provide similar services to non-affiliates at reasonable rates if requested. Not only would this help ensure that IAWC is not illegitimately cross-subsidizing its affiliate, but it would also be consistent with the Commission's order in Docket No. 00-0586. In that decision, for example, the Commission ruled "gas utilities shall not provide any preferences to affiliated interests in the release of billing and usage data." I interpret this to mean that, at a minimum, IAWC should offer its customer list to non-affiliates at the same rate it would charge AWR.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Because IAWC responded on Friday, March 7 to data requests regarding its proposed water line protection program, I reserve the right to file supplemental testimony at a later date. Subject to this reservation, this concludes my testimony.